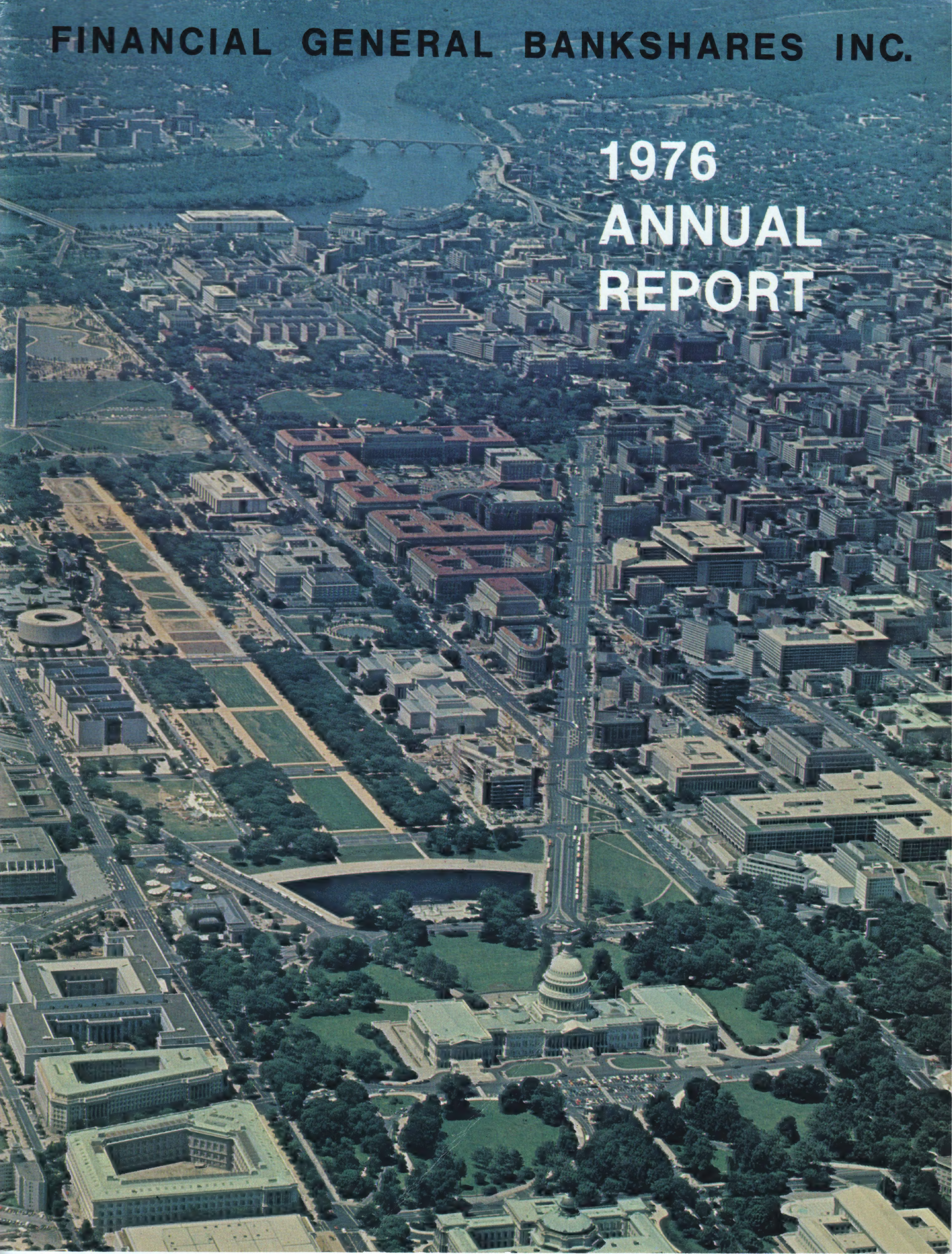
FINANCIAL GENERAL BANKSHARES INC.

1976 ANNUAL REPORT



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1701 PENNSYLVANIA AVENUE, N. W., WASHINGTON, D. C. 20006

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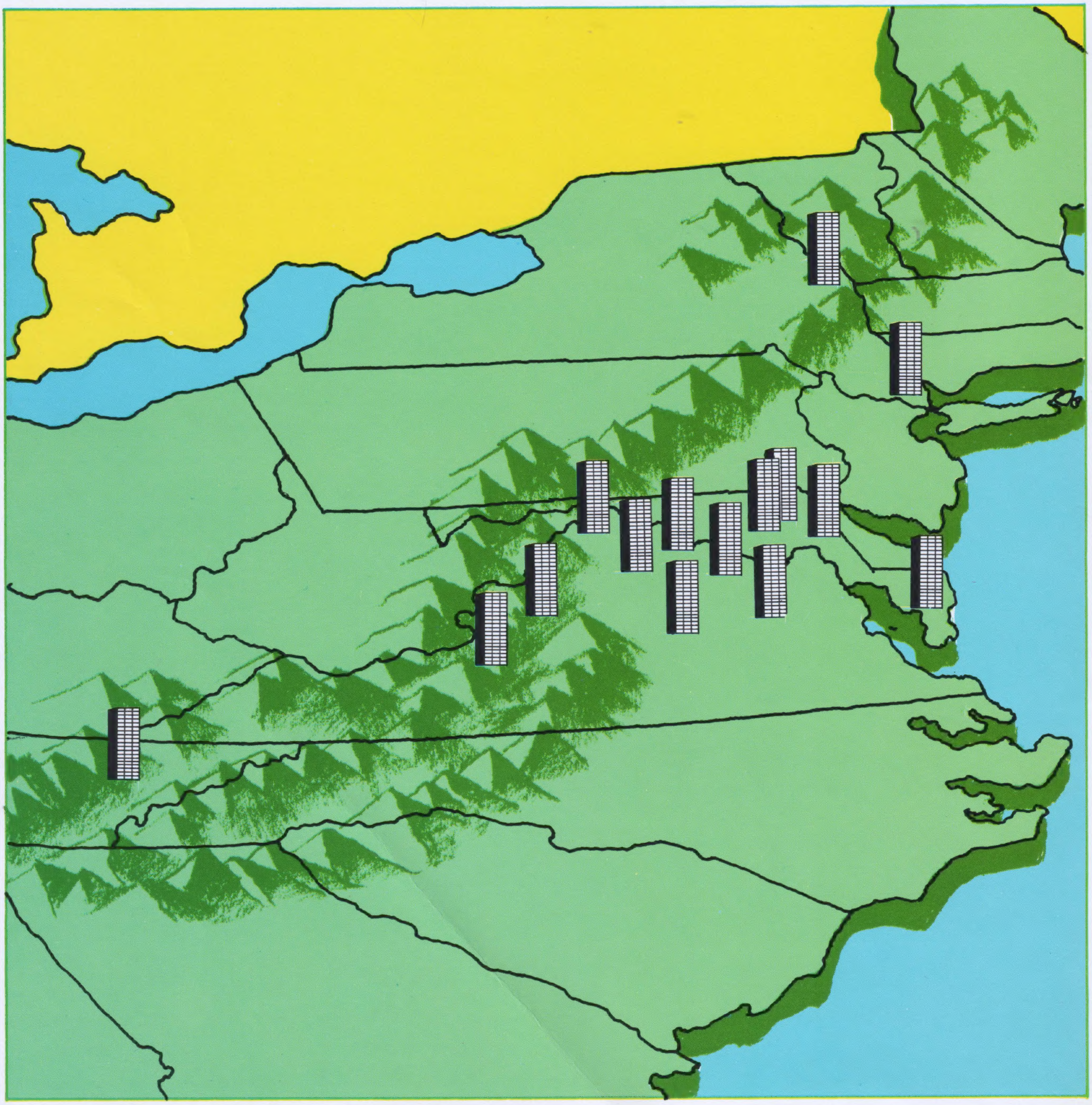


CONSOLIDATED SUMMARY

For The Year	1976	1975
Income before Security Gains and Extraordinary Credit	$10,386,000	$ 5,102,000
Per Share	$1.75	$0.86
Net Income	10,433,000	6,360,000
Per Share	1.76	1.07
Dividends Paid (historical)		
Common	0.36	0.36
Class A Common	0.36	0.36

At Year End		
Assets	$1,623,192,000	$1,541,280,000
Securities	522,666,000	464,077,000
Loans	810,142,000	794,844,000
Deposits	1,423,395,000	1,370,787,000
Shareholders' Investment	93,029,000	84,769,000

CONTENTS

A copy of the Company's 1976 Annual Report to the Securities and Exchange Commission on Form 10-K is available upon written request, directed to A. Vincent Scoffone, Vice President and Treasurer.

The Annual Meeting of Shareholders will be held at the John Marshall Hotel, Richmond, Virginia, on Wednesday, April 27, 1977, at 10:00 A.M.

TO OUR SHAREHOLDERS

An investor is assumed to have one of two objectives. His goal is either to increase his capital or to get a high cash return, or somewhere close to one of them. An investment will occasionally accomplish both objectives. However, the accomplishment of both objectives with a single investment is unusual. An investment in a well-managed bank or bank holding company will result in a steady appreciation of capital through retained earnings, in contrast to a high cash return on the investment. This is so because of the nature of banking. Prudent management and the requirements of various agencies responsible for bank regulation determine the relationship between total bank capital and bank deposits. Since bank deposits tend to increase each year, a substantial part of the earnings of each bank must be retained by the bank to support the growth in deposits. In turn, the growth in deposits is the base for growth in earnings.

Financial General banks operate under a policy of retaining 60% of earnings, which means that dividends normally will not exceed 40% of earnings. This is consistent with the policy of controlled growth adopted in 1975. Assuming a 0.9% return on assets, retained earnings in a bank will support an annual growth in deposits in the same bank of approximately 7.4%. The purpose of retaining earnings to support growth is to avoid calling upon shareholders of the banks and the holding company for additional capital. The policy is not a rigid rule,

but a flexible guide that allows for accommodating to changes during the year that are beyond the ability of the banks and the holding company to control.

Banks' earnings are primarily cash. Unlike banks, the Parent Company's earnings are partly cash and partly an interest in earnings retained by the banks. Earnings retained by the banks are reflected on the Parent Company Statement of Income as equity in undistributed income which is not available to meet cash requirements of the parent. The Parent Company must pay operating expenses, taxes, interest on Parent Company debt, any additional investments in banks, and dividends to shareholders from the cash it receives from the banks. While this results in a lower percent of earnings paid in cash by the holding company, the shareholder benefits over the longer term in proportion to the expense reduction for the banks that can be accomplished by the holding company. Other sections of this Annual Report will reflect actions that are now underway to reduce expenses and improve earnings.

Earnings for 1976 were $1.76 per share, as compared to $1.07 per share in 1975 adjusted for a 4% stock dividend in 1976. Thirty-four cents of the increase resulted from the sale of Financial General's investment in four banks and a bank service company in the Chicago area. This gain will not recur. Consequently, a better measure of improvement from banking and real estate operations is $1.42 per share for 1976, in contrast to $1.07 in 1975, for a gain of 32.7%. The Management Analysis on page 13 contains a detailed discussion of the composition of earnings for the year and provides a more comprehensive discussion of operations.

The banks continue to maintain their underlying strength individually and collectively. The capital/asset ratio is 7.9%. An acceptable ratio could be as low as 7.0%. A very conservative rate could be 9.5 to 10.0%. The lower the ratio the more aggressive the bank; and aggressiveness has an association with higher risk. The reserve for loan losses is 1.4% of loans. This reserve is adequate and compares favorably with the industry average.

The demand for loans continues to be soft. As a consequence, the group finished the year with a loan to deposit ratio of 55.5%, whereas a desirable ratio is 65.0%. The increases in the installment loan and real estate portfolios offset the softness in demand for commercial loans so that there was a slight gain in the total loan portfolio during the year.

The two real estate subsidiaries returned to profitable positions. National Mortgage Corporation had a net income of $434,000. H. G. Smithy Company had earnings of $372,000. The Company's equity in this income of $806,000 amounted to $688,000. However, a reserve of $700,000 ($490,000 after applicable tax benefit) was provided to offset the possible loss on the prospective sale of H. G. Smithy Company. Thus, the equity in income from the two real estate subsidiaries is $198,000.

On January 31, 1977, a letter of intent was signed to dispose of H. G. Smithy Company. The proposed purchase agreement provides that certain contractual responsibilities to the minority shareholders will be satisfied by the prospective purchasers. See Note 3 to the financial statements for a more complete description.

Loans to real estate investment trusts and investments in New York City securities pose no problems of significance to the Company. No bank in the family has a tanker loan.

1976 was a year of continuing consolidation and change. The year started with the merger of Union Trust Company and The First National Bank of Washington, with Union First National Bank of Washington as the result. Mid-January saw the completion of successful tender offers for additional shares of Chesapeake National Bank and Valley National Bank so that the Financial General share of Chesapeake now exceeds 92% and Valley National Bank is just under 83%.

The sale of our interest in the First National Bank of Lockport, Illinois was accomplished in April. In July, Financial General's holdings in three Chicago banks and a bank service company were sold. These transactions resulted in carrying forward our objective of concentrating a larger share of Financial General's total investments in the Virginia-Maryland-District of Columbia area.

Several management changes were made during the year. On March 1, 1976, G. J. (Bud) Manderfield assumed the position of President and Chief Executive Officer of American National Bank of Maryland. On July 1, George Olmsted relinquished his position as Chairman of the Board, and became Honorary Chairman of the Board. He continues as a director and serves as Chairman of the Executive Committee of the Board of Directors.

W. J. Schuiling retired as President and Chief Executive Officer, and assumed General Olmsted's position as Chairman of the Board of Directors. I assumed the responsibility for day-to-day management of the Company as President and Chief Executive Officer. My former position of Vice Chairman of the Board is vacant. In September, Fred E. Lybrand requested relief from his position as Chief Executive Officer of Bank of Commerce, New York City, due to health reasons. He continues as Chairman of the Board of Directors. Russell L. Weiss, who had been serving as President of Bank of Commerce, assumed the additional responsibility of Chief Executive Officer. In November, Clarence E. Visscher relinquished his position as Chief Executive Officer of Community State Bank of Albany, New York, and retired from his position as chairman in February, 1977. Gerald B. Fitzgerald was elected President of the Bank and Chief Executive Officer at the November, 1976 board meeting.

Other sections of this report describe our strong marketing area, the operating philosophy of the holding company and a general description of services provided to family banks by the holding company.

The management team in each of our banks continues to perform in an outstanding manner. The staff at the holding company has worked with exceptional effectiveness. We are grateful to our shareholders for your continued support. Financial General is proud of its accomplishments in 1976. We expect to exceed that performance in 1977.

From a personal point of view, I owe a debt of gratitude to Bill Schuiling. He made difficult decisions and took bold actions in 1974 and 1975 to provide the base for the improvement in earnings in 1976. The knowledge that he has gained in his 40 years in banking has contributed significantly to strengthening your company. His advice and counsel continue to be a source of strength.

Respectfully submitted,

Harold K Johnson

Harold K. Johnson
President and Chief
Executive Officer

THE CAPITAL MARKET

FINANCIAL GENERAL'S MARKET

During 1976, the Company continued its planned redeployment of resources along the Eastern Seaboard. As a result, the Company's banking interests now constitute a band of 15 banks extending from Albany, New York, in the north to Knoxville, Tennessee, in the south. Eighty-two percent of the Company's banking investments are concentrated in the Virginia-Maryland-District of Columbia area.

VIRGINIA-MARYLAND-DISTRICT OF COLUMBIA MARKET

In its major business area—the District of Columbia and immediate surrounding area—stability and growth go hand in hand. Metropolitan Washington with its government-oriented, virtually recession proof, service-based economy, is a complement to outlying regions where diversified commercial and industrial activity is subject to normal business cycles.

By itself, metropolitan Washington is the seventh largest such area in the United States. Baltimore is the eleventh. Together, the two regions combine to form the nation's fourth largest metropolitan complex, and its impact is felt throughout Virginia and Maryland.

In metropolitan Washington, the average household income of $17,000 is 35 percent above the national average. During the past two decades, the population has doubled to three million people and one million households, providing an important and stable base for consumer deposits. During the same period the federal government, large though it is, has actually diminished in local relative importance when compared to the growing private sector.

Metropolitan Washington is an important commercial market as well. More than 1,600 light manufacturing firms are located in and around this area. National companies with headquarters or major branches in the area complement the hundreds of service-related firms.

New construction continues throughout metropolitan Washington. The region averages 40,000 housing starts a year. In Fairfax County, Virginia, alone, 25,000 acres are zoned for future industrial growth.

Consumer buying power is above the national average. Disposable income has grown twice as fast as the increase in the cost of living. This results in one of the nation's most upwardly mobile population groups. Major highways interconnect locations in the region with more than 17 million square feet of retail selling space. Last year, retail sales in the Washington area topped $9.5 billion.

Not only is the economic growth of Washington and its suburbs attracting new business development, but the quality of life also encourages migration to the area. There is a wide diversity of living environments; residence choices range from 200-year-old brick townhouses in Georgetown and Alexandria, to modern high-rises in Arlington, to white-fenced farms in McLean and Potomac.

The region's environmental diversity is complemented by its scenic, educational, cultural and historical attributes. Twenty-five institutions of higher learning contribute to the comparatively high percentage of the population with a college degree. As the nation's economic activity has moved from the northeast southward, so too have the arts, making Wash-

Financial General serves this Market in and around our Nation's Capital City

ington one of the nation's foremost cultural centers.

Though the impact of the Washington metropolitan market is felt throughout Virginia and Maryland, the Company's banks take advantage of their own regional and local market characteristics.

OTHER FINANCIAL GENERAL MARKETS

Beyond the Virginia-Maryland-District of Columbia region, the southern and northern anchors in the Company's family of banks are also in important market areas. Knoxville, Tennessee, has become a regional center for retail and wholesale trade, with major national chemical and textile companies located in the area. Significant commercial and manufacturing activities, coupled with the University of Tennessee, contribute to the growing economy of Eastern Tennessee, where the unemployment rate is one of the lowest in the country. The area is currently in the midst of a construction boom.

Albany, New York, at the confluence of the Mohawk and Hudson rivers, is a central distribution center with major routes to points throughout the entire Northeast, and is a political and educational center as well. New York City, as the financial center of the world, continues to be one of the nation's largest markets.

In summary, Financial General's markets are rich with opportunities for business growth; each provides an excellent long-range potential for commercial banking.

THE FINANCIAL GENERAL BANKS

The Company is a major regional banking institution with 15 member banks in diversified markets on the Eastern Seaboard. The Company's banks range from Virginia's Shenandoah Valley to Maryland's Eastern Shore, with anchors in Albany and Knoxville. It is the only multi-state bank holding company with a member bank located in New York City.

The greater Washington market in its broadest sense constitutes the primary target for the Company's banking activity. This market provides a stable source of consumer deposits, and an expanding retail sector with attractive opportunities for corporate banking. FG banks serve a wide cross-section of customers, including apple-growers in the Shenandoah Valley of Virginia, watermen on the Eastern Shore of Maryland, government contractors in the area, students in many universities and working people everywhere. FG banks provide a total range of banking services and they are doing so with a style that sets them apart in an industry known for its uniformity.

The technological revolution in banking has accelerated the trend toward centralization. Autonomous banks which continue to offer personalized services, and have the resources to support major business development, are increasingly rare. *FG banks are exceptions.* The Company has not followed the general trend toward centralization. Instead, each of its 15 banks operates independently.

Each bank is organized to serve a specific market with particular needs. Each Chief Executive Officer, with the assistance of an active local Board of Directors, manages his bank with direct authority and responsibility for those decisions which affect his operation. The Company believes this is the best way to insure a continuation of decisive management which is responsive to customers' needs.

People think of a bank as an impersonal institution operating for a profit without regard for human needs. Financial General believes its operating philosophy encourages each member bank to act for the good of the community in which it exists, with due regard for the specific needs of the individuals in the community. We are proud that our banks have responded immediately to lessen the impact on their communities of downturns in the economy, vagaries of weather, and other physical disasters. We are proud that our banks have acted aggressively to assist in the emergence of new businesses, new services, and new ideas of energetic and imaginative individuals in the community. This has been the history of the development of our country, and Financial General Bankshares is strongly dedicated to its continuation.

We believe our support and assistance to applegrowers suffering losses

People serving you in Financial General Banks

in the severe frosts of 1976, and to watermen ice-bound on the Eastern Shore is indicative of this philosophy. The list is long. It includes an upstate New York plan to permit local citizens to pay their township taxes across a teller's window, a group plan for local companies that has free checking with savings, immediate cash withdrawal by use of a credit card, and direct deposits. In Tennessee, convenient automatic teller machines have been installed in several retail locations.

Ideas meriting support have not been neglected. A large dealership in Maryland grew from a member bank's financing of one man with a good idea, and a plan to meet the needs of his farming community. A farmer turned a part-time hobby into a profitable commercial business, raising cattle for direct and personal sale to consumers. He was able to do so because a member bank knew him to be a good credit risk. His loan application was reviewed and approved by local people who knew him and the market he planned to serve.

The list of services provided by each bank is as varied as the market. Financial General family banks are uniquely able to service customers in each of their specific markets as no other competitive banking institution can do. In short, the autonomous bank is a local bank making those decisions and providing those services that are best for the community it serves. Financial General banks operate autonomously.

SERVICE TO FIFTEEN AUTONOMOUS BANKS

Financial General Bankshares, the holding company for 15 autonomous banks, provides a range of common services which complements individual bank activities. A member bank with limited assets is able to offer its customers benefits of a collective banking institution with assets of $1.9 billion, services a small bank cannot afford alone.

In 1975, a budget planning program was initiated for all of the banks. Budgets for 1976 were prepared and quarterly reviews were conducted to compare performance with budget during 1976. As the year progressed, budget planning shifted gradually to profitability planning. In 1976, a goal of 0.9% return on assets was established for all of the banks. For 1977, a specific goal has been established for each bank that takes into account the market area, past earnings performance, and the potential for future earnings. More work is required to smooth out the planning procedures and the measurements of performance. As a result of this process, we anticipate improvements in earnings that will vary from bank to bank.

In 1975, the service support activities of the holding company made a forward stride with the acquisition of a computer center from three member banks. The wholly-owned center was re-designated Financial General Service Corporation (FGSC). During 1976, this large-scale computer center was engaged in converting to a highly advanced system designed to serve seven banks in the Washington area initially. By mid-1978, data processing services from FGSC will be available for the remaining five banks in Virginia and Maryland.

In addition to offering common services, the holding company provides its banks with assistance in serving large corporate accounts. As an example, an ongoing program facilitates inter-bank cooperation to meet loan requests that exceed the capability of a single bank. Each bank participating in the program does so voluntarily, and in conformity with its own loan policy.

Member banks draw upon a variety of other financial, legal and management services from the holding company. The Company regularly audits member bank financial records and performs the Directors' examination for most member banks on an annual basis. The Company provides staff assistance to member banks in preparing tax returns and planning the development of a desirable tax posture.

The Company makes available, as requested by member banks, advice and assistance on any special problems with regulatory agencies. In addition, the Company provides legal assistance to member banks for one time problems or activities, or in making loans that require experience

beyond that readily available on the bank staff. The Company also monitors pending legislative and regulatory developments and advises member banks as appropriate.

In 1976, a new staff service was initiated to provide member banks with market research data, advice on new marketing opportunities and branch analysis to assist the banks in remaining competitive.

The Company believes that its most important assets are the people who work to assure that bank services are responsive to customer needs. The Company supports upward job mobility for all employees who demonstrate a capability for added responsibility. It believes that increased salary and wage benefits are a deserved reward for work well done, and that recognition for superior performance is an essential element of an acceptable working environment.

The Company is developing the capability to provide its member banks with information and assistance on salary and wage plans, regional wage levels, cost-of-living index data, performance measurement and appraisal, training, and other programs relating to personnel communication and management. A staff position for this purpose was filled in October.

A group employee retirement plan and group insurance programs are also provided by the Company. In 1976, an Employee Stock Ownership Plan that purchases FG shares was made available to subsidiary banks. A substantial number of employees of FG banks now own shares of the parent company. This program fosters the spirit of collective cooperation existing throughout the family of banks.

FINANCIAL INFORMATION

Consolidated Summary of Operations

	1972	1973	1974	1975	1976
	Year Ended December 31 (in thousands)				
Interest revenue	$70,609	$89,503	$102,195	$101,404	$104,947
Interest expense	31,216	44,820	53,944	47,476	45,630
Interest, net	39,393	44,683	48,251	53,928	59,317
Gain on sales of investments in banks, net (Note 3)	—	—	—	734	3,167
Other operating revenues	7,455	8,505	8,219	8,323	8,936
Income before items shown below	46,848	53,188	56,470	62,985	71,420
Other operating expenses:					
Salaries and benefits (Note 8)	19,623	22,351	25,130	27,687	30,463
Provision for loan losses (Notes 1 and 5)	2,646	1,343	2,153	2,861	2,515
Other expenses	15,170	17,933	19,382	23,556	24,905
Total	37,439	41,627	46,665	54,104	57,883
Income before taxes, minority interests, equity in income (loss) of affiliates, unconsolidated subsidiaries, security transactions and extraordinary credit	9,409	11,561	9,805	8,881	13,537
Provision (credit) for taxes (Note 7)	47	956	(728)	1,579	896
Minority interests	3,003	3,720	3,326	2,916	2,908
	3,050	4,676	2,598	4,495	3,804
Income before equity in income (loss) of affiliates, unconsolidated subsidiaries, security transactions and extraordinary credit	6,359	6,885	7,207	4,386	9,733
Equity in income (loss) of affiliates and unconsolidated subsidiaries	2,148	2,328	1,088	771	456
Equity in income (loss) of unconsolidated real estate subsidiaries	189	270	(5,042)	(54)	198
Income before security transactions and extraordinary credit	8,696	9,483	3,253	5,103	10,387
Security gains (losses) net (Notes 1 and 2)	336	(190)	(108)	6	47
Income before extraordinary credit	9,032	9,293	3,145	5,109	10,434
Extraordinary credit (Note 7)	—	—	—	1,251	—
Net income	9,032	9,293	3,145	6,360	10,434
Dividends on Preferred Stock	82	77	71	65	60
Net income to common shareholders	$ 8,950	$ 9,216	$ 3,074	$ 6,295	$ 10,374
Earnings per share (Note 9):					
Average Common, Class A and Common Equivalents Outstanding	5,893	5,884	5,848	5,869	5,899
Income before security transactions and extraordinary credit	$ 1.46	$ 1.60	$ .55	$ .86	$ 1.75
Security gains (losses) net of taxes	.06	(.03)	(.02)	—	.01
Extraordinary credit	—	—	—	.21	—
Net income	$ 1.52	$ 1.57	$ .53	$ 1.07	$ 1.76
Cash dividends per share (b):					
Common	$ .21	$ .35	$ .33	$ .34	$ .35
Class A	.26	.33	.33	.34	.35
Stock dividends	5%	2½%	2½%	2½%	4%

NOTES: (a) The numerical note references are to Notes to Financial Statements.
(b) Per share amounts have been adjusted for stock dividends.

Management Discussion and Analysis of Operations

Net income to common shareholders for 1976 rose to $10,374,000, an increase of 64.8% over last year's $6,295,000. The reasons for this are shown in the following chart. The most significant changes are increased net interest income and gains on sales of investments. Operating expenses and salaries with related benefits have caused decreases in net income.

CHANGES IN NET INCOME
(in thousands)

	1975 Over 1974	1976 Over 1975
Increase in net interest margin	$5,520	$5,490
Change in tax equivalent adjustment	157	(101)
Gain on sales of investments	734	2,433
Increase in other operating revenues	104	613
Increase in salaries and related benefits	(2,557)	(2,776)
Change in provision for loan losses	(708)	346
Increase in other operating expenses	(4,174)	(1,349)
Change in provision for taxes	(2,307)	683
Decrease in minority interests	410	8
Change in equity in income of affiliates and unconsolidated subsidiaries	4,671	(63)
Increase in security gains	114	41
Change in extraordinary credit	1,251	(1,251)
Decrease in preferred dividends	6	5
Change in net income to common shareholders	$3,221	$4,079

Net interest income. The keys to determining Financial General's net interest earnings are: 1) the volume of earnings assets; 2) the yield on earning assets; 3) the volume of interest-bearing deposits and borrowed funds (liabilities); 4) the interest cost of the liabilities; and 5) the "spread" or difference between the asset yield and the cost of liabilities.

The total volume of earning assets has increased since 1974 as the Company has grown. This growth accounted for $4,712,000 in 1976 and $65,000 in 1975 of the dollar gain in asset yields. Changes in asset mix have altered the character of the income. As the economy reached the end of the recession in 1975, commercial loan volume decreased. This circumstance continued for 1976 as well. To compensate for the lack of commercial loans, our banks increased their consumer and real estate loans modestly. Funds not used for loans were invested in Federal Funds in 1975 and, as the rates fell, U. S. Treasury Securities and the securities of U. S. Government Agencies were purchased.

The yields on loans and investments have maintained relative stability during this three year period. Commercial loan yields have dropped somewhat but since our banks were able to make consumer and real estate

Yields on Earning Assets and Cost of Interest Bearing Liabilities

	1974		1975		1976	
	Average Balance	Rate	Average Balance	Rate	Average Balance	Rate
Yields on Earning Assets—			(in thousands)			
Loans:						
Commercial	$ 277,250	9.98%	$ 274,910	8.77%	$ 249,832	8.17%
Real estate	325,249	8.08	334,425	8.15	344,079	8.35
Installment	197,676	9.84	184,487	11.13	196,015	11.12
Total loans	800,175	9.17	793,822	9.06	789,926	8.98
Securities:						
U.S. Treasury	142,099	6.50	141,530	6.88	191,807	7.01
U.S. Government agencies	69,507	7.03	74,925	7.22	94,573	6.97
States and political subdivisions*	230,177	8.50	218,599	8.80	218,931	8.88
Other securities	5,695	6.27	5,893	8.13	4,103	5.83
Total securities	447,478	7.61	440,947	7.90	509,414	7.80
Federal funds sold	39,697	10.41	63,174	6.14	62,915	5.79
Total earning assets	1,287,350	8.67	1,297,943	8.50	1,362,255	8.39
Cost of Interest Bearing Liabilities—						
Time deposits	754,834	6.39	763,653	5.72	790,526	5.39
Borrowed funds:						
Federal funds purchased	27,160	9.71	15,560	5.75	22,310	4.53
Capital notes	4,905	5.86	4,551	5.93	4,201	5.95
Other long-term borrowings (principally from banks)	23,913	11.22	29,854	8.20	22,614	7.40
Short-term bank borrowings	1,544	9.65	2,980	8.77	829	10.61
Total borrowed funds	57,522	9.92	52,945	7.22	49,954	6.05
Total funds	812,356	6.64	816,598	5.82	840,480	5.43
Net Interest to Total Earning Assets*	$ 474,994	4.48%	$ 481,345	4.87%	$ 521,775	5.04%
Interest Rate Spread*		2.03%		2.68%		2.96%

*On a fully taxable equivalent basis.

loans, this did not have a great effect on the income of the Company.

Liabilities consist of demand deposits, time deposits and various borrowed funds. As loan demand slackened, the need for high-cost certificates of deposit decreased. This had a favorable effect on the net interest income. At the same time, lower cost savings deposits increased in volume. In addition, demand deposits have grown steadily over the three year period. The net effect is that while deposits have increased, the cost of these deposits has decreased. During 1975, the cost of time deposits decreased $4,586,000 from 1974 and during 1976 costs decreased $1,044,000 from 1975.

Cost decreases have been accompained by lower levels of borrowed funds. Bank borrowings to fund new loans were no longer necessary. The borrowings of the parent Company were paid down as certain investments were sold. This decrease in volume of borrowed funds had only a minor impact on the net interest income.

The cost of the Company's borrowed funds is related to the prime rate. As the loan demand diminished, so did the prime rate for commercial loans. This had the beneficial effect of reducing the cost of funds. Borrowings had been used for increases in the capitalization of our banks during earlier fast growth periods. The net effect of rate decreases was to lower the cost of borrowed funds $1,882,000 during 1975 and $803,000 during 1976.

The results of these changes in the earning assets and the liabilities of the Company were increases of $5,520,000 and $5,490,000 in net interest income during 1975 and 1976 respectively.

Sales of Investments

As part of its continuing effort to consolidate its holdings in the Virginia-Maryland-District of Columbia area, the Company has sold several of its investments during the last two years. The gains on the sales of these investments have significantly increased earnings.

During 1976, the Company sold its minority interests in four Chicago-area banks and a bank service company—Heritage First National Bank of Lockport, Heritage County Bank and Trust Company, Heritage Pullman Bank and Trust Company, Heritage Standard Bank and Trust Company and Heritage Bancorporation. It also exchanged its investment in Central National Bankshares, Inc. for an investment in Pioneer Hi-Bred International, Inc. The net effect of these transactions is the $3,167,000 reported gain on sales of investments.

During 1975, the Company sold its investments in Bank of Buffalo and The National Bank of Georgia for a net financial gain of $734,000. The Company bene-

Change in Net Interest Income

	1975			1976		
	Change Due to: Volume	Rate	Total Change	Change Due to: Volume	Rate	Total Change
	(in thousands)					
Earning Assets—						
Loans:						
Commercial	$ (206)	$(3,334)	$(3,540)	$(2,139)	$(1,567)	$(3,706)
Real estate	746	211	957	797	668	1,465
Installment	(1,297)	2,377	1,080	1,281	(17)	1,264
Total loans	(757)	(746)	(1,503)	(61)	(916)	(977)
Securities:						
U.S. Treasury	(36)	529	493	3,519	185	3,704
U.S. Government agencies	388	136	524	1,368	(185)	1,183
States and political subdivisions*	(984)	657	(327)	29	181	210
Other securities	13	109	122	(129)	(111)	(240)
Total securities	(619)	1,431	812	4,787	70	4,857
Federal funds sold	1,441	(1,698)	(257)	(14)	(223)	(237)
Total earning assets	65	(1,013)	(948)	4,712	(1,069)	3,643
Interest Bearing Liabilities—						
Time deposits	504	(5,090)	(4,586)	1,448	(2,492)	(1,044)
Borrowed funds:						
Federal funds purchased	(941)	(802)	(1,743)	305	(188)	117
Capital notes	(21)	4	(17)	(21)	1	(20)
Other long-term borrowings	480	(700)	(220)	(576)	(165)	(741)
Short-term borrowings	119	(21)	98	(178)	19	(159)
Total borrowed funds	(363)	(1,519)	(1,882)	(470)	(333)	(803)
Total funds	141	(6,609)	(6,468)	978	(2,825)	(1,847)
Net Interest Income*	$ (76)	$ 5,596	$ 5,520	$ 3,734	$ 1,756	$ 5,490

*On a fully taxable equivalent basis.

fited from an extraordinary credit of $1,251,000 in 1975 as a result of using its net operating loss carry-forward to offset taxes on these sales.

The Company has no plans at this time for any further divestitures with the exception of those non-banking activities which are prohibited under the provisions of the Bank Holding Company Act.

Operating Expenses

Operating expenses were affected by general inflationary increases in the costs of goods and services used by the Company. Salaries and related costs are the largest components of operating expenses, amounting to $30.5 million in 1976, an increase of 10.0% over 1975. Total employment at the beginning of 1974 stood at 2,300. At the end of 1976, it was 2,500 as the Company has grown and expanded.

During 1976, the Company's Employee Stock Ownership Plan was offered to its subsidiary banks. Eleven of thirteen eligible banks joined during the year which resulted in an increase in payments to the Plan of $534,000 over the 1975 levels. In addition, pension costs for all the Company plans have risen as the plans were amended to conform to the Employee Retirement Income Security Act. The amendments, coupled with an increase in the number of banks participating, resulted in pension costs increasing $335,000 for 1975 and $831,000 for 1976 as more employees were covered and adjustments were made for salary level increases.

In 1975, other operating expense also included a provision for $600,000 in state taxes on the sales of two subsidiary banks and a write-down of $824,000 on other investments to estimated market value.

Loan loss reserves continue to be maintained at approximately 1.4% of average total loans notwithstanding economic recovery and reduced charge-offs as a result of improving economic conditions. Loan charge-offs were lower in 1976 than in 1975. As a consequence, the addition to the loan loss reserve, which is a charge against income, was $346,000 lower than in 1975.

Provision for Taxes

The effective tax rate on earnings was 6% in 1976 and 19% in 1975. The principal reason for the difference between these rates and the 48% corporate tax rate is the Company's investment in state and municipal securities. The income from these securities is tax-exempt. The Company considers its holdings of these securities as support of local governments.

Other changes in the provision for taxes were caused by a number of factors. These include the gains on sales of banks, taxes at the capital gains rate on the sales of other investments and various timing differences and tax credits. A detailed discussion of the tax reconciliation and analysis is included in Note 7 to the financial statements.

Equity in Income of Affiliates and Unconsolidated Subsidiaries

The Company's income has been significantly affected by changes in its equity in the income of its affiliates and unconsolidated subsidiaries. Equity in the income of American National Bank of Maryland and Community State Bank decreased due to additional charge-offs. The income of the two subsidiary banks sold in 1975 was not available in 1976. Equity in the income of unconsolidated real estate subsidiaries continued to increase with further improvement in the real estate industry.

Summary

In summary, net interest income and gains on sales of investments have had the most significant favorable effect on the Company's income. Provision for losses on loans, salaries and related benefits, reduction in equity in the income of unconsolidated subsidiaries and affiliates and other operating expenses have had an unfavorable effect.

COMMON STOCK DATA

The Company has two classes of common stock eligible to vote at the Annual Meeting, Common Stock and Class A Common Stock, Series 1. Both classes of stock are traded on the American Stock Exchange. The Transfer and Dividend Disbursing Agent is Union First National Bank of Washington. The following closing sales prices and dividends have been adjusted for the 4% stock dividend in 1976 and the 2½% stock dividend in 1975 for both classes of stock during the past two years:

PRICE RANGE	Common		Class A	
1975	High	Low	High	Low
1st Quarter	5⅝	3⅞	5⅝	3⅞
2nd Quarter	6	4¾	5¾	4⅝
3rd Quarter	7¼	5⅝	6½	5
4th Quarter	6	5	5⅝	4¾
1976				
1st Quarter	7½	5⅜	7¼	5⅜
2nd Quarter	7⅝	6¼	6⅝	6⅛
3rd Quarter	8½	6¼	8¼	6¼
4th Quarter	8½	7	8⅜	6⅞

DIVIDENDS		
1975	Common	Class A
1st Quarter	.085	.085
2nd Quarter	.085	.085
3rd Quarter	.085	.085
4th Quarter	.087	.087
1976		
1st Quarter	.087	.087
2nd Quarter	.087	.087
3rd Quarter	.087	.087
4th Quarter	.090	.090

The Financial Condition of Member Banks

AT

	No. of Banking Offices 1976	Total Assets		Cash and Securities		Loans	
		1976	1971	1976	1971	1976	1971
VIRGINIA-MARYLAND-DISTRICT OF COLUMBIA BANKS							
Union First National Bank of Washington (D.C.)	18	$ 509,234	$ 409,219	$269,938	$223,777	$230,872	$178,171
American National Bank of Maryland (Silver Spring)	19	170,952	148,140	85,826	78,439	79,897	65,041
Chesapeake National Bank (Towson, Md.)	4	37,097	21,991	11,168	10,742	25,352	10,956
Eastern Shore National Bank (Md.)	5	36,156	23,557	18,222	11,296	17,404	12,270
Arlington Trust Company, Inc. (Fairfax County, Va.)	15	246,295	165,228	122,279	79,708	120,289	83,737
Clarendon Bank & Trust (Fairfax County, Va.)	16	233,406	142,015	81,437	70,881	132,551	69,179
Alexandria National Bank of Northern Virginia	11	137,595	88,406	62,025	38,954	70,398	47,104
Shenandoah Valley National Bank (Winchester, Va.)	5	62,631	36,198	23,606	13,071	38,162	23,055
Valley National Bank (Harrisonburg, Va.)	4	44,327	28,112	18,785	13,774	24,668	13,549
The Peoples National Bank of Leesburg (Va.)	5	34,544	24,852	15,399	14,667	18,515	9,798
The Round Hill National Bank (Va.)	2	16,368	12,615	7,461	7,230	8,627	5,379
The First National Bank of Lexington (Va.)	2	10,729	7,859	3,658	4,066	6,742	3,701
	106	1,539,334	1,108,192	719,804	566,605	773,477	521,940
		5.9%		3.7%		7.4%	
NEW YORK AND TENNESSEE BANKS							
Bank of Commerce (New York City)	20	236,497	205,277	115,742	83,762	116,779	119,095
Community State Bank (Albany, N.Y.)	7	45,911	45,106	17,580	22,189	26,891	21,865
Valley Fidelity Bank and Trust Company (Knoxville, Tenn.)	8	130,360	86,679	65,028	43,180	62,181	41,848
	35	412,768	337,062	198,350	149,131	205,851	182,808
		3.7%		5.2%		2.2%	
	141	$1,952,102	$1,445,254	$918,154	$715,736	$979,328	$704,748
Compound growth rate over the 5 year period.		5.4%		4.0%		6.2%	

EAR END

FOR YEAR

(000 Omitted)

Loan Loss Reserves 1976	Loan Loss Reserves 1971	Deposits 1976	Deposits 1971	Equity Capital 1976	Equity Capital 1971	Net Operating Earnings 1976	Net Operating Earnings 1971	Net Income 1976	Net Income 1971	FG % of Ownership 1976
$ 3,480	$ 2,627	$ 431,921	$ 372,524	$ 39,158	$24,984	$ 3,593	$ 3,127	$ 3,611	$ 3,674	84.6
1,100	921	155,301	134,737	13,168	10,649	112	856	101	872	45.1
327	168	32,745	20,143	3,609	1,648	306	161	306	161	92.7
260	208	33,046	21,619	2,889	1,878	327	237	341	200	83.0
1,717	1,563	224,568	151,798	18,166	10,371	2,398	2,210	2,400	2,232	80.1
1,334	1,156	214,086	131,327	17,258	6,703	1,653	1,081	1,654	1,111	55.1
906	703	122,024	82,207	10,594	6,066	1,040	677	1,040	766	83.9
519	519	56,716	32,669	5,601	2,899	546	377	565	391	66.7
289	234	40,460	25,926	2,814	1,316	428	175	428	176	82.7
292	146	31,643	23,027	2,488	1,680	310	152	310	167	88.0
112	88	14,766	11,887	1,430	687	161	116	178	130	62.7
94	79	9,821	7,115	829	564	120	92	120	92	73.5
10,430	8,412	1,367,097	1,014,979	118,004	69,445	10,994	9,261	11,054	9,972	
3.3%		5.4%		12.8%		3.1%		1.7%		
1,537	1,985	215,288	185,800	18,489	15,776	1,776	1,632	1,767	1,647	67.6
409	260	40,634	41,548	3,776	3,161	(27)	51	(9)	408	83.3
753	778	117,080	79,294	10,890	6,722	1,424	871	1,426	919	36.6
2,699	3,023	373,002	306,642	33,155	25,659	3,173	2,554	3,184	2,974	
(2.6%)		3.5%		5.4%		3.2%		1.2%		
$13,129	$11,435	$1,740,099	$1,321,621	$151,159	$95,104	$14,167	$11,815	$14,238	$12,946	
1.9%		4.9%		10.9%		3.1%		1.6%		

Consolidated Balance Sheet

FINANCIAL GENERAL BANKSHARES, INC. AND SUBSIDIARIES
as of December 31, 1976 and 1975

	1976	1975
ASSETS		
Cash and Due from Banks (Note 6)	$ 134,135,235	$ 147,192,619
Securities (Notes 1 and 2):		
U.S. Treasury	196,898,365	162,965,896
U.S. Government Agencies and Corporations	94,244,475	86,950,919
States and Political Subdivisions	228,285,982	209,427,723
Other	3,237,283	4,732,757
Total Securities	522,666,105	464,077,295
Federal Funds Sold	90,630,000	73,050,000
Loans (Notes 1, 4 and 5):		
Commercial Loans	252,489,824	271,475,697
Real Estate Mortgage Loans	359,003,831	334,247,969
Installment Loans	228,413,042	217,468,524
Unearned Interest Income	(29,764,300)	(28,348,545)
Total Loans	810,142,397	794,843,645
Less: Reserve for Loan Losses	(10,868,553)	(11,017,961)
Net Loans	799,273,844	783,825,684
Investments (Notes 3 and 4):		
Affiliated Controlled Banks, at equity in underlying net assets	9,776,326	9,573,691
Unconsolidated Subsidiary Bank, at equity in underlying net assets	3,143,426	3,219,102
Unconsolidated Real Estate Subsidiaries, principally at equity in underlying net assets	4,342,235	4,986,842
Other Investments, at cost	2,306,170	3,246,217
Total Investments	19,568,157	21,025,852
Bank Premises and Equipment, net (Note 1)	35,728,339	31,101,907
Other Assets (Note 1)	21,189,969	21,006,619
	$1,623,191,649	$1,541,279,976
LIABILITIES AND SHAREHOLDERS' INVESTMENT		
Demand Deposits	$ 610,512,743	$ 589,657,012
Time Deposits	812,882,034	781,130,194
Total Deposits	1,423,394,777	1,370,787,206
Federal Funds Purchased	39,212,000	12,209,000
Borrowed Funds (Note 6)	25,581,665	30,774,125
Other Liabilities (Notes 1 and 7)	12,721,388	13,615,242
	1,500,909,830	1,427,385,573
Minority Interests	29,252,548	29,125,426
Commitments and Contingencies (Notes 6 and 8)		
Shareholders' Investment (Notes 6 and 9):		
Preferred Stock, at voluntary liquidation value	1,321,060	1,443,572
Class A Common Stock, $.10 par value (voluntary liquidation value of $5,432,955 in 1976)	49,390	47,491
Common Stock, $.10 par value	539,083	517,285
Common Stock Purchase Warrants	237,974	251,556
Paid-in Surplus	41,811,447	40,002,659
Retained Earnings ($47,069,445 restricted in 1976 as to future payment of dividends)	49,142,343	42,550,719
Treasury Stock, at cost	(72,026)	(44,305)
	93,029,271	84,768,977
	$1,623,191,649	$1,541,279,976

The accompanying notes are an integral part of this statement.

Consolidated Statement of Income

FINANCIAL GENERAL BANKSHARES, INC. AND SUBSIDIARIES
for the Years Ended December 31, 1976 and 1975

	1976	1975
OPERATING REVENUES:		
Interest and fees on loans	$ 70,928,529	$ 71,904,935
Interest on Federal funds sold	3,639,924	3,877,200
Interest and dividends on securities—		
U.S. Treasury	13,436,719	9,733,414
U.S. Government agencies and corporations	6,590,306	5,407,042
States and political subdivisions	10,112,409	10,002,546
Other	238,695	479,098
Service charges on deposit accounts	3,070,915	2,969,245
Trust department income	1,675,897	1,516,902
Other service charges and fees	1,653,954	1,444,447
Gain on sales of investments in banks, net (Note 3)	3,167,435	733,996
Other	2,534,768	2,391,933
	117,049,551	110,460,758
OPERATING EXPENSES:		
Salaries and related benefits (Note 8)	30,462,714	27,686,955
Interest on time deposits	42,607,183	43,651,281
Interest on Federal funds purchased	1,011,124	894,065
Interest on other borrowed funds	2,011,501	2,930,806
Occupancy and equipment (Note 8)	9,314,427	8,281,667
Provision for loan losses (Notes 1 and 5)	2,515,420	2,861,322
Other	15,590,655	15,273,662
	103,513,024	101,579,758
	13,536,527	8,881,000
PROVISION FOR INCOME TAXES (Note 7)	896,000	1,579,000
MINORITY INTERESTS	2,907,840	2,916,423
	3,803,840	4,495,423
Income before equity in income (loss) of affiliates, unconsolidated subsidiaries, security gains and extraordinary credit	9,732,687	4,385,577
EQUITY IN INCOME (LOSS) OF (Notes 1 and 3):		
Affiliated controlled banks	463,563	515,152
Unconsolidated subsidiary banks	(7,357)	255,338
Unconsolidated real estate subsidiaries	197,558	(53,799)
	653,764	716,691
Income before security gains and extraordinary credit	10,386,451	5,102,268
SECURITY GAINS, net (Notes 1 and 2)	47,008	6,456
Income before extraordinary credit	10,433,459	5,108,724
EXTRAORDINARY CREDIT—Utilization of net operating loss carryforward (Note 7)	—	1,251,000
Net income	10,433,459	6,359,724
DIVIDENDS ON PREFERRED STOCK	(59,839)	(65,189)
Net income to common shareholders	$ 10,373,620	$ 6,294,535
PER SHARE OF COMMON AND CLASS A COMMON (Note 9):		
Income before security gains and extraordinary credit	$1.75	$ .86
Security gains	.01	—
Extraordinary credit	—	.21
Net income	$1.76	$1.07

The accompanying notes are an integral part of this statement.

Consolidated Statement of Changes in Financial Position

FINANCIAL GENERAL BANKSHARES, INC. AND SUBSIDIARIES

for the Years Ended December 31, 1976 and 1975

	1976	1975
FINANCIAL RESOURCES WERE PROVIDED FROM:		
Operations:		
Net income	$ 10,433,459	$ 6,359,724
Equity in undistributed income of affiliates and unconsolidated subsidiaries, before deferred taxes	(76,582)	(307,392)
Minority interests, including those in security gains	2,923,766	2,911,829
Depreciation and amortization	2,218,389	1,937,075
Deferred Federal income taxes	486,000	374,000
Provision for loan losses	2,515,420	2,861,322
Write-down of other investments	—	823,516
	18,500,452	14,960,074
Increases (decreases) in liabilities:		
Deposits	52,607,571	63,913,404
Federal funds purchased	27,003,000	(9,888,000)
Borrowed funds	(5,192,460)	(8,447,135)
	74,418,111	45,578,269
Proceeds from sales of investments (net of gains of $3,167,435 in 1976 and $733,996 in 1975)	890,047	12,764,376
Other, net (principally change in minority interests)	(4,238,637)	(5,537,757)
	(3,348,590)	7,226,619
	89,569,973	67,764,962
FINANCIAL RESOURCES WERE USED FOR:		
Increases (decreases) in earning assets:		
Securities	58,588,810	62,247,526
Federal funds sold	17,580,000	(3,375,000)
Loans, before charge-offs	17,963,580	(20,493,558)
Investments in affiliates and unconsolidated subsidiaries	(644,230)	(837,683)
	93,488,160	37,541,285
Additions to premises and equipment	6,844,821	9,079,846
Cash dividends	2,111,026	2,059,305
Other, net	183,350	1,883,015
	102,627,357	50,563,451
INCREASE (DECREASE) IN CASH AND DUE FROM BANKS	($ 13,057,384)	$17,201,511

The accompanying notes are an integral part of this statement.

Consolidated Statement of Changes in Shareholders' Investment

PARENT COMPANY AND SUBSIDIARIES

for the Two Years Ended December 31, 1976

	Preferred Stock	Class A Common Stock	Common Stock	Common Stock Purchase Warrants	Paid-in Surplus	Retained Earnings	Treasury Stock
Balances, December 31, 1974	$1,570,348	$46,333	$504,669	$251,556	$39,069,212	$39,087,678	($20,732)
Contribution to capital of real estate subsidiary					224,190		
Reduction in equity in underlying net assets of subsidiary bank due to merger					(141,102)		
Purchase and retirement of 2,438 shares of preferred stock	(126,776)				26,755		
2½% stock dividend on common and Class A common, at quoted market, including purchase of 4,170 fractional shares		1,158	12,616		823,604	(837,378)	(23,573)
Cash dividends—							
Preferred stock—$2.25 per share						(65,189)	
Class A common stock—$.36 per share						(167,695)	
Common stock—$.36 per share						(1,826,421)	
Net income						6,359,724	
Balances, December 31, 1975	1,443,572	47,491	517,285	251,556	40,002,659	42,550,719	(44,305)
Issuance of 11,007 shares of common stock on exercise of 6,523 warrants			1,101	(13,582)	78,097		
Purchase and retirement of 2,356 shares of preferred stock	(122,512)				22,478		
4% stock dividend on common and Class A common, at quoted market, including purchase of 3,481 fractional shares		1,899	20,697		1,708,213	(1,730,809)	(27,721)
Cash dividends—							
Preferred stock—$2.25 per share						(59,839)	
Class A common stock—$.36 per share						(172,416)	
Common stock—$.36 per share						(1,878,771)	
Net income						10,433,459	
Balances, December 31, 1976	$1,321,060	$49,390	$539,083	$237,974	$41,811,447	$49,142,343	($72,026)

The accompanying notes are an integral part of this statement.

Balance Sheet

FINANCIAL GENERAL BANKSHARES, INC. (PARENT COMPANY)

as of December 31, 1976 and 1975

	1976	1975
ASSETS		
Investments:		
Consolidated Subsidiary Companies (mainly banks), principally at equity in underlying net assets (Note 1)	$ 94,858,201	$ 87,910,376
Affiliated Controlled Banks, at equity in underlying net assets (Note 3)	9,776,326	9,573,691
Unconsolidated Subsidiary Bank, at equity in underlying net assets (Note 3)	3,143,426	3,219,102
Unconsolidated Real Estate Subsidiaries, principally at equity in underlying net assets (Note 3)	4,342,235	4,986,842
Other Investments, at cost (Notes 3 and 4)	2,306,170	3,246,217
	114,426,358	108,936,228
Cash (Note 6)	1,099,006	3,085,092
Receivables, including $1,971,888 in 1976 and $1,846,013 in 1975 from subsidiaries (Note 4)	2,119,078	1,931,935
Other Assets	272,972	188,915
	$117,917,414	$114,142,170
LIABILITIES AND SHAREHOLDERS' INVESTMENT		
Liabilities:		
Accounts Payable and Accrued Liabilities	$ 794,179	$ 1,450,342
Dividends Payable (Note 6)	542,825	523,166
Federal Income Taxes (Note 7)	2,360,439	1,410,245
Borrowed Funds (Note 6)	21,190,700	25,989,440
Total Liabilities	24,888,143	29,373,193
Commitments and Contingencies (Notes 6 and 8)		
Shareholders' Investment (Notes 6 and 9):		
Preferred Stock, at voluntary liquidation value	1,321,060	1,443,572
Class A Common Stock, $.10 par value (voluntary liquidation value of $5,432,955 in 1976)	49,390	47,491
Common Stock, $.10 par value	539,083	517,285
Common Stock Purchase Warrants	237,974	251,556
Paid-in Surplus	41,811,447	40,002,659
Retained Earnings ($47,069,445 restricted in 1976 as to future payment of dividends)	49,142,343	42,550,719
Treasury Stock, at cost	(72,026)	(44,305)
	93,029,271	84,768,977
	$117,917,414	$114,142,170

The accompanying notes are an integral part of this statement.

Statement of Income

FINANCIAL GENERAL BANKSHARES, INC. (PARENT COMPANY)

for the Years Ended December 31, 1976 and 1975

	1976	1975
INCOME:		
Cash dividends from—		
Consolidated subsidiary banks	$ 4,379,170	$3,863,699
Affiliated controlled banks	357,928	348,745
Unconsolidated subsidiary banks	74,089	477,554
Unconsolidated real estate subsidiaries	32,165	—
Minority banks	83,262	233,226
Others, mainly from International Bank	127,954	107,618
	5,054,568	5,030,842
Service fees from banks	630,241	415,526
Gain on sales of investments in banks, net (Note 3)	3,167,435	733,996
Other	222,193	366,646
	9,074,437	6,547,010
EXPENSES:		
Interest	1,743,090	2,605,054
Salaries and related benefits (Note 8)	901,945	789,908
Legal, professional and consulting fees (Note 4)	660,968	1,131,503
State and local taxes	242,704	619,411
Write-down of other investments (Notes 3 and 4)	—	823,516
Other	636,081	406,780
	4,184,788	6,376,172
	4,889,649	170,838
FEDERAL INCOME TAX PROVISION (CREDIT) (Note 7)	(575,000)	71,000
Income before equity in undistributed income (loss) of subsidiaries and affiliates and extraordinary credit	5,464,649	99,838
EQUITY IN UNDISTRIBUTED INCOME (LOSS) OF:		
Consolidated subsidiary companies (mainly banks)	4,779,228	5,118,494
Affiliated controlled banks (Notes 3 and 7)	105,635	166,407
Unconsolidated subsidiary banks (Notes 1, 3 and 7)	(81,446)	(222,216)
Unconsolidated real estate subsidiaries (Note 3)	165,393	(53,799)
	4,968,810	5,008,886
Income before extraordinary credit	10,433,459	5,108,724
EXTRAORDINARY CREDIT — Utilization of net operating loss carryforward (Note 7)	—	1,251,000
Net income	10,433,459	6,359,724
DIVIDENDS ON PREFERRED STOCK	(59,839)	(65,189)
Net income to common shareholders	$10,373,620	$6,294,535

The accompanying notes are an integral part of this statement.

Statement of Changes in Financial Position

FINANCIAL GENERAL BANKSHARES, INC. (PARENT COMPANY)
for the Years Ended December 31, 1976 and 1975

	1976	1975
SOURCES OF FUNDS:		
Net income	$10,433,459	$ 6,359,724
Equity in undistributed income of subsidiaries and affiliates	(4,968,810)	(5,008,886)
Write-down of other investments	—	823,516
Provided from operations	5,464,649	2,174,354
Increase in borrowed funds	—	2,515,540
Proceeds from sales of investments (net of gains of $3,167,435 in 1976 and $733,996 in 1975)	890,047	12,764,376
Increase in other liabilities, net	281,702	182,263
	6,636,398	17,636,533
USES OF FUNDS:		
Additional investments, net	1,524,363	3,035,502
Cash dividends	2,111,026	2,059,305
Purchase of treasury shares, net of proceeds from exercise of warrants in 1976	62,139	123,594
Reduction in borrowed funds	4,798,740	10,577,160
Increase in other assets, net	126,216	55,930
	8,622,484	15,851,491
INCREASE (DECREASE) IN CASH	($ 1,986,086)	$ 1,785,042

The accompanying notes are an integral part of this statement.

Notes to Financial Statements

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of Financial General Bankshares, Inc. are in accordance with generally accepted accounting principles and conform to general practices within the banking industry. Some of the more significant accounting policies are as follows:

Basis of Presentation

The accompanying consolidated financial statements include the accounts of Financial General Bankshares, Inc. (the Company) and its majority-owned subsidiaries, except for one bank and two real estate subsidiaries (see Note 3 for discussion); the Company's investments in these three subsidiaries are accounted for using the equity method of accounting.

The accompanying Parent Company financial statements include the accounts of the Company and six wholly-owned holding companies which hold investments in subsidiary and affiliated controlled banks and have no operations, outside debt, or transactions other than with the Parent Company.

All significant intercompany accounts and transactions have been eliminated.

Securities

Securities are stated at cost, adjusted for amortization of premiums and accretion of discounts. Security gains, as reflected in the consolidated statement of income, are net of applicable tax provisions and minority interests.

Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation and amortization of $17,377,918 in 1976 and $16,738,759 in 1975. Depreciation and amortization ($2,218,389 in 1976 and $1,937,075 in 1975) are provided primarily on the straight-line method over estimated useful lives ranging from 3 to 50 years.

Cost in Excess of Equity in Net Assets of Subsidiaries

The cost of the Company's investment over its equity in the net assets of consolidated subsidiaries ($411,387) is included in "Other Assets" in the consolidated balance sheet and is being amortized over a 40 year period.

Unearned Interest Income

Interest applicable to installment loans is recognized as income principally by use of the sum-of-the-months-digits method.

Reserve for Loan Losses

The reserve for loan losses is based on the subsidiaries' past loan loss experience and such other factors which, in management's judgment, deserve current recognition in estimating loan losses.

Federal Income Taxes

The Company files a consolidated Federal income tax return with its includible subsidiaries, that is, subsidiaries in which there is an 80% or more stock interest. The Company charges the includible subsidiaries with the amounts such subsidiaries would have paid or, in the case of losses, credits such subsidiaries with amounts which would have been refunded, had they filed individual company returns. The Company pays the tax liability which is computed on a consolidated return basis. Subsidiaries in which the Company owns less than 80% file their returns and pay their taxes on an individual company basis.

Deferred income taxes are not provided on the Company's portion of undistributed earnings of its less than 80% owned consolidated subsidiaries, since it is management's intention to have the applicable subsidiaries utilize such earnings in their operations, thereby investing the undistributed earnings indefinitely.

Deferred taxes on the equity in undistributed earnings of affiliated controlled banks are provided either at ordinary rates applicable to dividends (where the Company contemplates holding its investment in the bank and it is assumed that applicable undistributed earnings will be received in the form of dividends if and when remitted) or at capital gains rates (where management has not made a decision concerning the future retention of the investment in the bank).

(2) SECURITIES

A comparison of the book value and market value by maturity of investment securities (in thousands) at December 31, 1976 and 1975 is as follows:

	1976		1975	
	Book Value	Market Value	Book Value	Market Value
U.S. Treasury				
Within 1 year	$ 61,586	$ 59,995	$ 51,042	$ 51,362
After 1 but within 5 years	114,496	119,781	87,334	87,421
After 5 but within 10 years	20,807	22,021	24,562	24,327
After 10 years	10	10	28	26
	$196,899	$201,807	$162,966	$163,136
U.S. Government Agencies				
Within 1 year	$ 40,906	$ 41,095	$ 29,167	$ 29,242
After 1 but within 5 years	42,083	43,225	46,036	45,699
After 5 but within 10 years	8,702	8,861	9,191	8,727
After 10 years	2,554	2,625	2,557	2,497
	$ 94,245	$ 95,806	$ 86,951	$ 86,165
States and Political Subdivisions				
Within 1 year	$ 14,200	$ 14,253	$ 24,570	$ 24,388
After 1 but within 5 years	86,625	88,236	85,843	84,130
After 5 but within 10 years	110,244	113,148	81,247	77,173
After 10 years	17,217	17,789	17,768	16,481
	$228,286	$233,426	$209,428	$202,172

	1976		1975	
	Book Value	Market Value	Book Value	Market Value
Other				
Bonds, notes and debentures	$ 1,721	$ 1,651	$ 3,780	$ 3,614
Federal Reserve Bank stock	1,425	1,425	869	869
Other stock	91	91	83	83
	$ 3,237	$ 3,167	$ 4,732	$ 4,566

Securities having an adjusted cost of approximately $136,965,000 at December 31, 1976, and $135,308,000 at December 31, 1975, were pledged with the U.S. Government and various state and governmental agencies to secure deposits as required by law.

(3) INVESTMENTS

Investments included in the consolidated balance sheet are as follows:

Affiliated Controlled Banks

Summary combined financial data for American National Bank (45.1% owned) and Valley Fidelity Bank and Trust Company (36.6% owned) are as follows:

	1976	1975
Assets:		
Cash and securities	$146,853,889	$150,530,204
Loans, net	144,224,496	133,507,465
Other assets	10,234,113	9,407,156
Total assets	301,312,498	293,444,825
Liabilities:		
Deposits	(272,381,219)	(266,166,662)
Other liabilities	(4,874,030)	(3,834,739)
Total capital funds	$ 24,057,249	$ 23,443,424
Company's equity in capital funds	$ 9,776,326	$ 9,573,691
Revenues	$ 23,114,889	$ 21,851,502
Net income	$ 1,526,713	$ 1,640,112
Company's equity in net income (including dividends of $357,928 in 1976 and $348,745 in 1975)	$ 463,563	$ 515,152

The Company had previously entered into agreements to sell its investment (183,195 shares of common stock) in Valley Fidelity Bank and Trust Company; however, these sales were not consummated. The Company does not have plans to sell its investment in Valley Fidelity at this time. Management has made the decision to continue to provide deferred taxes at the capital gains rate rather than the dividend rate. Deferred taxes provided in 1976 and 1975 applicable to the undistributed earnings of this bank were $97,000 and $84,000, respectively.

Unconsolidated Subsidiary Banks

In 1975, the Company entered into negotiations to sell its 83% investment (103,376 shares of common stock) in Community State Bank; however, the sale was not consummated. The Company has not made a final decision concerning the retention of this bank.

During 1975, the Company sold its 61% interest in the Bank of Buffalo and its 60% interest in The National Bank of Georgia for $13,498,372 which resulted in a net gain, for financial reporting purposes, of $733,996. The Company's equity in the banks' net income to the dates of sale in 1975 amounted to $412,010. Current taxes of $1,054,000 were provided in 1975, resulting primarily from deferred taxes not being previously provided on the Company's equity in undistributed earnings of The National Bank of Georgia as the Company did not decide to sell that bank until 1975 (see Note 1 for discussion of the Company's tax accounting policies).

Unconsolidated Real Estate Subsidiaries

Since 1974, the Company has accounted for its investments in two real estate subsidiaries, National Mortgage Corporation (96% owned) and the H. G. Smithy Company (69% owned) using the equity method of accounting since, under the requirements of the Bank Holding Company Act, the Company will be unable to retain after 1978 more than a 5% interest in these two subsidiaries. During 1976, the Company entered into negotiations for the sale of its investment in H. G. Smithy Company. On January 31, 1977, the Company executed a letter of intent to sell this investment, the terms of which provide for release of the Company's liability to purchase shares tendered by certain officers and directors of H. G. Smithy. The Company had not previously performed on its obligation to purchase the tendered shares because legal counsel has advised the Company that the purchase would violate the Bank Holding Company Act. A provision of $700,000 ($490,000 after applicable tax benefit) was provided in 1976 for anticipated losses on the disposition of these subsidiaries.

Summary combined financial data for unconsolidated real estate subsidiaries are as follows:

	1976	1975
Assets:		
Cash and due from banks	$ 4,806,119	$ 4,786,710
Loans and investments	10,921,118	14,326,691
Less - Reserve for losses	(3,750,609)	(4,676,601)
Other assets	1,553,024	1,559,347
Total assets	13,529,652	15,996,147
Liabilities:		
Borrowed funds	(6,417,324)	(8,671,163)
Other liabilities	(3,235,645)	(4,199,956)
Shareholders' equity	$ 3,876,683	$ 3,125,028
Company's equity in net assets (including notes receivable of $2,000,000 and less a reserve for loss discussed above)	$ 4,342,235	$ 4,986,842
Revenues	$ 4,157,611	$ 3,577,501
Net income	$ 805,682	$ 14,455
Company's equity in net income including dividends of $32,165 and less a provision for loss discussed above)	$ 197,558	($ 53,799)

Other Investments

During 1976, the Company sold its minority interests in four Midwestern banks and a bank service company—Heritage First National Bank of Lockport, 14.9% owned; Heritage County Bank and Trust Company, 14.9% owned; Heritage Pullman Bank and Trust Company, 14.9% owned; Heritage Standard Bank and Trust Company, 20.3% owned; and Heritage Bancorporation, 15.9% owned—for $4,048,331 which resulted in a gain, for financial reporting purposes, of $3,170,482 (gain after applicable income taxes was $2,020,482).

In 1975, the Company entered into an option agreement (exercised in January, 1976) for the sale of its investment in Central National Bancshares, Inc. in exchange for Pioneer Hi-Bred International, Inc. common stock (29,918 unregistered shares, $1.00 par value) and reduced the carrying amount of its investment in Central National Bancshares, Inc. as of December 31, 1975, to quoted market ($628,278) by a charge to income of $280,296.

See Note 4 for investment in International Bank.

(4) INVESTMENT IN AND TRANSACTIONS WITH THE PRINCIPAL SHAREHOLDER

Included in "Other Investments" in the consolidated and parent company balance sheet is the Company's investment in International Bank (the principal shareholder of the Company) which is summarized as follows:

	1976		1975	
	Shares	Amount	Shares	Amount
International Bank:				
Preferred Stock, $3 Cumulative, Series A (unregistered)	26,000	$1,300,000	27,000	$1,350,000
Class A Comon Stock, $.25 Cumulative (quoted market $437,000 in 1976 and $260,000 in 1975)	94,473	377,892	94,473	377,892
		$1,677,892		$1,727,892

International Bank has agreed to redeem annually 1,000 shares of its Series A Preferred Stock at $50 per share, up to an aggregate of 10,000 shares. During 1975, the Company reduced the carrying amount of its investment in International Bank's Class A common stock by a charge to income of $543,220.

Subsidiaries and affiliates of International Bank, as well as some of its officers and directors, have had loans and other banking transactions with subsidiary banks of the Company. The amounts of outstanding loans at December 31, 1976 and 1975 are summarized as follows:

	1976	1975
Subsidiaries and Affiliates	$3,237,000	$ 9,731,000
Officers and Directors	1,964,000	3,754,000
	$5,201,000	$13,485,000

The aggregate amount of these loans approximates 0.6% and 1.7% of outstanding loans at December 31, 1976, and 1975, respectively, and includes loans, direct and indirect, of $1,255,000 in 1976 and $2,465,000 in 1975, to Mr. George Olmsted, director of the Company and principal shareholder of International Bank.

Management of the Company is of the opinion that the aforementioned loans and transactions were made in the ordinary course of business and on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated parties.

In 1975, in connection with Mr. Olmsted's resignation under his retirement contract with the Company, the Board of Directors approved a $270,000 consulting agreement whereby Mr. Olmsted would assist over a three year period in the formulation and execution of the Company's long-term objectives; this $270,000 was charged to income in 1975.

See Note 6 for indebtedness guarantee for a subsidiary of International Bank and Note 8 for terms of the Company's lease agreement with International Bank.

The Board of Governors of the Federal Reserve System has issued determinations that International Bank is a "Bank Holding Company" by virtue of its interest in the Company. These determinations are being contested by International Bank. Pending final determination, the Company has been unable to obtain approval for the acquisition of additional banks. Should it be finally determined that International Bank is a bank holding company, and International Bank registers as a bank holding company, joint application by the Company and International Bank would be required for the Company to acquire additional banks. In January 1977, the Company was advised that International Bank intends to sell all shares of the Company owned by it and has received a conditional offer to purchase such shares, which International Bank is prepared to accept, if all conditions are satisfied.

(5) RESERVE FOR LOAN LOSSES

An analysis of the consolidated reserve for loan losses is as follows:

	1976	1975
Balance, beginning of year	$11,017,961	$11,142,333
Provision charged to income	2,515,420	2,861,322
Recoveries	738,479	699,614
Loans charged off	(3,403,307)	(3,685,308)
Balance, end of year	$10,868,553	$11,017,961

(6) BORROWED FUNDS

Borrowed funds at December 31, 1976 and 1975 are summarized as follows:

	1976	1975
Parent Company:		
Short-term borrowings from non-affiliated banks with interest approximately 1% above prime	$ —	$ 1,800,000
Short-term unsecured note payable to non-affiliated individual estate with interest at 7½% per annum, due July 31, 1976	—	265,540
Unsecured borrowings from non-affiliated banks with interest rates ranging from ½% to 2% above prime, payable in varying amounts through 1979	19,497,700	21,840,900
5¼% Subordinated sinking fund debentures, payable $193,000 in 1977 and $1,500,000 in June, 1978	1,693,000	2,083,000
	21,190,700	25,989,440
Consolidated Subsidiaries:		
Capital notes, 5% to 8%, payable in varying amounts through 1993	4,051,003	4,403,710
Mortgage indebtedness secured by certain bank premises	339,962	380,975
	4,390,965	4,784,685
	$25,581,665	$30,774,125

The following table reflects the maturities of borrowed funds for each of the next five years and thereafter:

	Parent Company	Consolidated Subsidiaries	Consolidated
1977	$ 2,011,200	$ 401,242	$ 2,412,442
1978	4,028,440	409,205	4,437,645
1979	15,151,060	417,636	15,568,696
1980	—	161,566	161,566
1981	—	571,500	571,500
After 1981	—	2,429,816	2,429,816
	$21,190,700	$4,390,965	$25,581,665

The maximum amount of aggregate short-term borrowings at any month-end was $2,066,000 in 1976 and $3,475,000 in 1975. The aggregate weighted average principal outstanding was $853,000 in 1976, and $2,185,000 in 1975, with a weighted average interest rate of 7.8% in 1976 and 8.4% in 1975. In addition to the above indebtedness, a non-affiliated bank has extended to the Company an unsecured line of credit of $3,000,000. At December 31, 1976, no borrowings were outstanding under this line of credit.

Debt Covenants

Under the unsecured borrowing agreement with a nonaffiliated bank, the Company is required to maintain consolidated compensating balances on deposit with the bank equal to 20% of the total amount outstanding ($18,475,000 outstanding at December 31, 1976).

Prepayment of the unsecured borrowings is required upon sale or other disposition of capital stock or assets of any of the Company's subsidiaries. The amount of the prepayment ranges from 50% to 100% of the pretax cash proceeds of the sale. During 1975, the Company prepaid $7,151,000 of the Parent Company's debt with the proceeds from the sale of two subsidiaries (Note 3).

The Company must, among other things, maintain consolidated shareholders' investment (as defined) of $77,000,000, and is restricted to indebtedness, as defined, of 49% of consolidated shareholders' investment. In addition, the Company cannot pay cash dividends without prior consent of the lending bank for any one fiscal year in excess of $.36 per share on Common and Class A Common Stock, and $2.25 per share on Cumulative Preferred Stock, Series A, the aggregate of which cannot be in excess of 25% of the average adjusted consolidated net income for the two preceding years. At December 31, 1976, $47,069,445 of consolidated retained earnings is restricted as to future payment of dividends. Also, the loan agreement prohibits payment of a stock dividend in excess of 2½% on the Class A or Common Stock and permits such stock dividend only if the Company has made mandatory or optional prepayments in any year of at least $1,000,000.

The Company obtained a waiver of certain of these restrictions relating to the payment of cash and stock dividends during 1976.

Contingent Liability

The Company and Financial Security Corporation (wholly-owned subsidiary of International Bank, the principal shareholder of the Company) are jointly and severally liable for the 5¼% Subordinated Sinking Fund Debentures ($1,693,000) and also the portion (aggregating $1,147,000 as of December 31, 1976) of such debentures assumed by Financial Security Corporation pursuant to the Company's divestiture of Financial Security Corporation in 1968 under the Bank Holding Company Act of 1956, as amended. The Company and/or International Bank and Financial Security Corporation can cause a default under the debenture agreement. The Company has been informed by International Bank that neither International Bank nor Financial Security Corporation has caused any default under such agreement.

(7) FEDERAL INCOME TAXES

An analysis of the components of the consolidated Federal income tax provision for 1976 and 1975 is as follows:

	1976	1975
Income taxes on operating earnings:		
Current tax provision	$ 666,000	$1,703,000
Deferred tax provision	599,000	(18,000)
Investment tax credit	(369,000)	(106,000)
Provision for income taxes in consolidated statement of income	896,000	1,579,000
Deferred income taxes on affiliates and unconsolidated subsidiaries, net	(113,000)	392,000
Income tax provision on security gains	27,000	4,000
	$ 810,000	$1,975,000

The deferred tax provision (credit) on operating earnings, shown above, arises because certain income and expense items are reported for financial statement reporting purposes in periods other than those in which they are reported for income tax return purposes. An analysis of the deferred tax provision, by principal timing differences, is as follows:

	1976	1975
Conversion from accrual to cash basis	$315,000	$280,000
Loan loss provision, net	(109,000)	(219,000)
Utilization of net operating loss deduction	136,000	—
Recognition of losses (write-downs) on investments	135,000	(343,000)
Amortization of unearned discount	134,000	82,000
Utilization of investment tax credit	109,000	—
Accretion of bond discounts	(86,000)	127,000
Gain on involuntary conversion	—	32,000
Other, net	(35,000)	23,000
	$599,000	($18,000)

Deferred income taxes have not been provided on the Company's portion of undistributed earnings of its less than 80% owned consolidated subsidiaries, since it is management's intention to have the applicable subsidiaries utilize such earnings in their operations, thereby investing the undistributed earnings indefinitely. The Company's equity in undistributed earnings of such subsidiaries available for distribution to the Company, after considering restrictions of regulatory authorities, was approximately $7,375,000 at December 31, 1976, and $6,730,000 at December 31, 1975. The approximate income taxes thereon, after considering deductions resulting from dividends received, would be $531,000 and $485,000, respectively.

The Federal tax provision for 1976 and 1975 is lower than that which would result from applying the U.S. statutory rate of 48%. A reconciliation of the 48% rate to the effective rate is as follows:

	1976	1975
Expected tax on operating earnings at 48%	$6,498,000	$4,263,000
Tax exempt municipal interest	(4,804,000)	(4,714,000)
Gain for tax purposes in excess of the gain for financial purposes on the sales of Bank of Buffalo and The National Bank of Georgia	—	2,132,000
Reduction of taxes due to gain on sale of investments taxed at capital gains rate	(530,000)	—
Provision (credit) of consolidated return companies not included in financial consolidation	173,000	(11,000)
Additional credit of financial consolidated companies not included in tax consolidation (primarily surtax exemptions)	(72,000)	(94,000)
Investment tax credit	(369,000)	(106,000)
Minimum tax on preference items	—	109,000
Actual tax provision	896,000	1,579,000

	1976	1975
Expected tax on equity in earnings of unconsolidated subsidiaries and affiliates at 48%	596,000	532,000
Equity in net earnings of unconsolidated subsidiaries and affiliates on which no tax provision or benefit has been recorded and reversal of expected tax applicable to banks held for sale (taxes actually provided at capital gains rate below)	(499,000)	(532,000)
Tax benefit on provision for loss on disposition of unconsolidated real estate subsidiaries	(210,000)	—
Provision for deferred income taxes on equity in undistributed earnings of banks to be sold	—	392,000
Actual tax provision	(113,000)	392,000
Expected tax provision on net security gains at 48%	43,000	7,000
Difference due to amount provided at capital gain rates or gains on which taxes are not currently provided	(16,000)	(3,000)
Actual tax provision	27,000	4,000
Total actual tax provision	$ 810,000	$1,975,000
Effective tax rate	6%	19%

At December 31, 1976, the Company had investment tax credit carryforwards of $261,000 for financial reporting purposes and $391,000 for tax return purposes. These credits expire in varying amounts through 1983.

For financial reporting purposes, the Company utilized all of its net operating loss carryforwards in 1975 which resulted in an extraordinary credit of $1,251,000 in 1975.

The Internal Revenue Service has completed an examination of the Company's tax returns for the years 1968 through 1970, but no final determination of any additional taxes has been made. In management's opinion, additional taxes (if any) will not have a significant effect on the Company's financial statements.

(8) COMMITMENTS AND CONTINGENCIES

Leases

The Company leases on a month-to-month basis from International Bank, the principal shareholder of the Company, office space in the Olmsted Building, Washington, D.C., at an annual rental of approximately $63,000. Some of the subsidiary companies lease land, buildings, furniture and fixtures. Rental expense of the consolidated subsidiary companies amounted to $4,187,899 in 1976 and $3,185,757 in 1975.

Minimum future annual rentals are payable as follows:

1977	$ 2,746,940
1978	2,595,435
1979	2,461,509
1980	2,214,908
1981	2,090,110
1982-1986	8,194,866
1987-1991	3,887,650
1992-1996	1,378,198
After 1996	1,752,932
	$27,322,548

Some of these leases are considered to be financing leases, but the effect of capitalizing such leases would not be material.

Employee Retirement, Profit Sharing and Stock Ownership Plans

The Company and its subsidiaries provide various noncontributory pension plans for employees who meet certain age and service requirements. Pension costs under the plans are funded when accrued and include amortization of past service costs ranging from 10 to 30 years. Total pension expense was $2,363,958 in 1976 and $1,532,938 in 1975.

The actuarially computed value of vested benefits at January 1, 1976 (date of the latest actuarial reviews) exceeded the plans' assets by approximately $2,700,-000. Unfunded past service costs at that date were approximately $7,300,000. The amounts of the actuarially computed value of vested benefits, fund assets, and unfunded past service costs are not available at December 31, 1976.

The Company's retirement plans have been amended to comply with the provisions of the Employee Retirement Income Security Act of 1974.

Certain of the subsidiary companies have profit sharing plans for salaried employees. Contributions to the plans amounted to $302,406 in 1976 and $340,655 in 1975.

The Company also provides an Employee Stock Ownership Plan to employees who meet certain age and service requirements. Payments equal to 5% of the eligible employees' compensation (as defined) are paid to a Trustee for the purchase of Company stock. Employees vest in their share of the Plan at the rate of 40% after completing four years of service and 10% thereafter for each additional year up to ten years. The Company contributed $17,422 to the Plan in 1975. At December 31, 1976, fourteen of the Company's majority-owned subsidiaries are participants in the Plan along with the Parent Company. Total contributions to the Plan amounted to $551,339, in 1976. The Plan is subject to revisions and amendments at the discretion of the Company's Board of Directors.

Litigation

Certain of the Company's subsidiary banks are parties to various legal proceedings. Litigation discussed in the Company's 1975 annual report involving a consolidated subsidiary bank and an affiliated controlled bank has been dismissed or otherwise settled without cost to the banks. With respect to other litigation involving the Company's subsidiaries, management and legal counsel are of the opinion that the ultimate resolution of such matters will not result in any material loss to the subsidiaries (or, accordingly, to the Company).

Other Matters

In the normal course of business, the Company's subsidiaries have various commitments and contingent liabilities outstanding such as letters of credit, guarantees and commitments to extend credit. Of these, stand-by letters of credit amounted to $5,439,000 at December 31, 1976. As set forth in Note 6, the Company is also contingently liable on indebtedness of an affiliated company.

(9) SHAREHOLDERS' INVESTMENT

Shares authorized, issued and outstanding at December 31, 1976 and 1975, are summarized as follows:

	1976	1975
Cumulative Preferred Stock:		
Series A—$2.25 dividend, $1.00 par value—		
Authorized	25,405	27,761
Issued and outstanding	25,405	27,761
Class A Common Stock:		
Series 1—$.10 par value—		
Authorized	1,000,000	1,000,000
Issued	493,905	474,909
Held in Treasury	(912)	(664)
Outstanding	492,993	474,245
Common Stock, $.10 par value:		
Authorized	7,000,000	7,000,000
Issued	5,390,827	5,172,854
Held in Treasury	(11,211)	(7,647)
Outstanding	5,379,616	5,165,207

Cumulative Preferred Stock

The Cumulative Preferred Stock, Series A, has preference in voluntary and involuntary liquidation of $52 and $50 per share, respectively, and is subject to redemption, at the election of the Board of Directors, at $52 per share, plus accrued dividends in each case. So long as any of these shares are outstanding and provided preferred dividends are not in arrears, the Company is required to pay, on June 1 and December 1 of each year, $50,000 to a Purchase Fund Agent for the purchase of such shares at prices not in excess of $52 per share. An additional 200,000 shares of Preferred Stock is authorized and the Board of Directors may issue these shares in series and establish the rate of dividend, voting rights, conversion rights, etc., if any.

Class A Common Stock

The Class A Common Stock, Series 1 (a) has preference in voluntary and involuntary liquidation of $11 per share (after all distributions on the Cumulative Preferred Stock), (b) is entitled to one vote per share (the Common stock is entitled to ten votes per share) and cumulative dividends of $.30 per share per annum and (c) shares equally with common shareholders in any cash dividends in excess of $.30 per share per annum and distributions upon liquidation in excess of $11 per share. An additional 6,000,000 shares of Class A Common Stock are authorized and the Board of Directors may issue these shares in series and establish the rate of dividend, voting rights, conversion rights, etc., if any.

Common Stock Purchase Warrants

At December 31, 1976, 194,288 shares of unissued Common Stock are reserved for issuance to holders of warrants issued in connection with the 5¼% Subordinated Sinking Fund Debentures. Each warrant entitles the holder to purchase 1.7 shares of Common Stock at $5.92 per share at any time prior to June 15, 1978.

Earnings Per Share

The computation of earnings per share has been based on the weighted average number of Common and Class A Common shares outstanding, including applicable common stock equivalents, after giving effect to preferred stock dividends of $59,839 in 1976 and $65,189 in 1975. Common shares issuable on exercise of warrants have been excluded as common stock equivalents in the computation of earnings per share in 1975 as their effect would be anti-dilutive. The weighted average number of Common and Class A Common shares was 5,898,518 in 1976 and 5,868,906 in 1975. The per share amounts for 1975 have been restated for the 4% stock dividend paid on December 20, 1976.

(10) QUARTERLY RESULTS FOR 1976 (Unaudited and in thousands)

	First	Second	Third	Fourth
Operating Revenues	$27,709	$28,553	$31,667	$29,121
Income before security gains	1,993	2,366	3,872	2,155
Net income	1,997	2,383	3,889	2,164
Earnings per share (Note 9)	$ .34	$ .40	$ .65	$ .37

Third quarter earnings include gains, after applicable income taxes, on sales of investments in banks of $1,822,000 or $.31 per share. See Note 3 for discussion.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Shareholders of
Financial General Bankshares, Inc.:

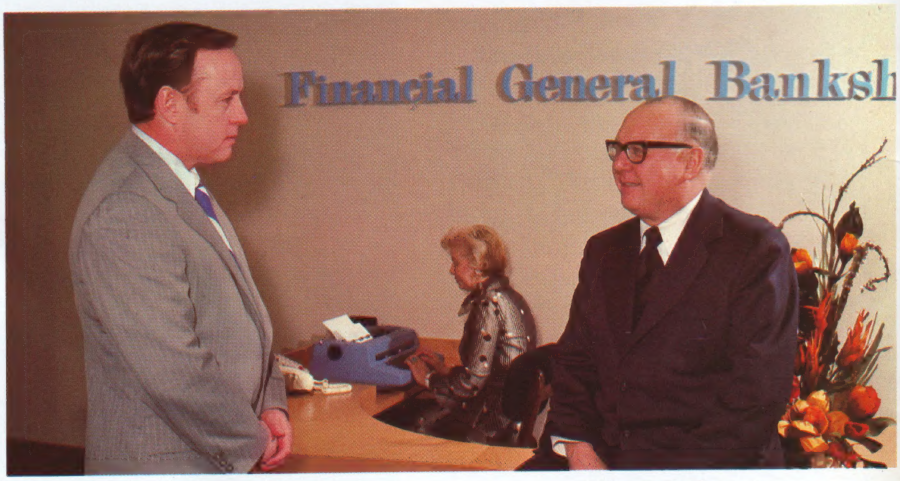
We have examined the consolidated balance sheet of Financial General Bankshares, Inc. (a Virginia corporation) and subsidiaries and the balance sheet of Financial General Bankshares, Inc. (parent company) as of December 31, 1976, and December 31, 1975, and the related statements of income, changes in shareholders' investment and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Financial General Bankshares, Inc. and subsidiaries, and of Financial General Bankshares, Inc. (parent company) as of December 31, 1976, and December 31, 1975, and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied during the periods.

ARTHUR ANDERSEN & CO.

1666 K Street, N.W.
Washington, D.C.,
February 24, 1977.

Harold K. Johnson *George Olmsted* *William J. Schuiling*



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Washington, D.C. 20005

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